

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION OF THE KENTUCKY)	
INTRASTATE RATES OF SOUTH CENTRAL)	CASE NO. 10105
BELL TELEPHONE COMPANY)	

O R D E R

INTRODUCTION

On September 30, 1988, the Commission entered an Order in this case. In part, the Order approved an incentive regulation plan. Also, the Order deferred two issues to further consideration. These issues are (1) whether customer credits/refunds or rate adjustments should be used to implement any earnings sharing that might occur under the incentive regulation plan and (2) the design of schedules to implement any rate adjustments that might occur under the incentive regulation plan.

The following parties participated in this investigation: AT&T Communications of the South Central States, Inc. ("AT&T"); the Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division ("Attorney General"); Contel of Kentucky, Inc. ("Contel"); GTE South Incorporated ("GTE"); MCI Telecommunications Corporation ("MCI"); and South Central Bell Telephone Company ("South Central Bell").

The Commission received prefiled testimony as follows:

1. On behalf of AT&T, Testimony of L. G. Sather, Staff Manager, Marketing Plans Implementation, filed on January 6, 1989.

2. On behalf of the Attorney General, Testimony of Marvin H. Kahn, consultant to the Attorney General, filed on January 6, 1989.

3. On behalf of Contel, Testimony of O. Douglas Fulp, Manager, Revenue Requirements/Pricing, filed on January 6, 1989.

4. On behalf of GTE, Testimony of Norman L. Farmer, Director, Revenues and Earnings Management, filed on January 6, 1989.

5. On behalf of MCI, Testimony of Loren D. Burnette, Manager, Telco Cost Management, filed on January 9, 1989. The Testimony of Mr. Burnette was adopted by Maureen Hedlund, Manager, Telco Cost Analysis and Operations.

6. On behalf of South Central Bell, Testimony of James H. Anderson, Assistant Vice President, Rates and Economics, filed on January 6, 1989.

A public hearing was held on February 14, 1989 to permit the presentation of testimony and the cross-examination of witnesses. The resulting Transcript ("Tr.") was filed on February 24, 1989.

The Commission received post hearing briefs as follows:

1. Brief of AT&T, filed on March 10, 1989.
2. Brief of the Attorney General, filed on March 10, 1989.
3. Brief of Contel, filed on March 10, 1989.

4. Brief of GTE, filed on March 10, 1989.

5. Brief of South Central Bell, filed on March 10, 1989.

The Commission received post hearing reply briefs as follows:

1. Reply Brief of AT&T, filed on March 15, 1989.

2. Reply Brief of South Central Bell, filed on March 15, 1989.

All information requested by the Commission and the parties has been filed.

DISCUSSION

Credits or Rate Reductions

In its September 30, 1988 Order the Commission determined that it would use either a credit or rate reduction procedure as a method for sharing benefits/costs from the incentive regulation plan. The Commission deferred its decision on which of the two methods it would adopt pending its decision on South Central Bell's proposed schedules of rate decreases and rate increases. All parties to the proceeding were provided an opportunity at the February 14, 1989 hearing to address both the benefit/cost and the feasibility of implementing each method.

In amending its incentive regulation plan in July 1989, South Central Bell proposed that rate reductions be adopted as the method for sharing the benefits of the incentive regulation plan with its customers. South Central Bell contended that rate reductions provide it an opportunity to address ". . . some of the pricing problems that we [South Central Bell] have." By

addressing these pricing problems, South Central Bell argues ". . . contributions would be available to hold down basic rates. . . prevent[ing] customers from unreasonably leaving the network because of uneconomically priced [lower] alternatives."¹

AT&T, GTE and Contel concurred with South Central Bell's position that rate reductions were preferable to rate refunds. GTE contended that "rate reductions address any overpricing problem, but rate credits do not."²

The Attorney General and MCI opposed the adoption of South Central Bell's proposal to reduce rates prospectively. The Attorney General's witness contended that information on costs and market conditions in this record ". . . is not near the information necessary to adequately determine what changes in the Company's [South Central Bell's] rate design are appropriate." Further, the Attorney General argues that refund credit mechanisms should benefit ". . . all South Central Bell subscribers and not only some select portion of that subscriber body."³

As an alternative the Attorney General and MCI proposed that the Commission adopt a rate credit mechanism as the appropriate method to share benefits from the earnings resulting from the incentive regulation plan. The Attorney General's witness, Dr. Kahn, proposed that the ". . . refund or credit be done on a proportional basis." He contended that ". . . it benefits all

¹ Tr., page 36.

² Brief of GTE, page 2.

³ Tr., page 225.

customers and all [customers] directly, we are not benefiting some at the expense of others."⁴ Finally, the Attorney General argued that credits have the advantage of administrative ease.

The Commission in determining the proper mechanism for sharing the costs and benefits of the incentive regulation plan has applied three different criteria in its consideration. First, the Commission believes that to the maximum extent possible any revenue benefits resulting from the plan should accrue to the ultimate telephone end user. The Commission is of the opinion that the rate reduction proposal does meet this criterion whereas with the refund or credit it is less certain. The Commission realizes that under South Central Bell's proposed schedule of rate decreases, only specific service subscribers will receive the benefits and not the general body of ratepayers. However, with rate reductions, the Commission can ensure that South Central Bell's rates for these services do reflect the lower revenue requirements resulting from the rate incentive plan. Under the proposed refund or credit, the Commission is convinced that it will be more difficult to require interexchange carriers to reduce their rates as a result of an uncertain credit.

Secondly, the Commission is convinced that the sharing mechanism should be administratively simple and implemented using the traditional tariffing mechanism. In reviewing the Attorney General's and South Central Bell's proposals, the Commission simply is not convinced that either offers benefits over the

⁴ Tr., page 227.

other in administration. The Commission does believe that current tariff review procedures will provide it adequate opportunity to review each of the proposed tariffs in sufficient detail to ensure that they comply with the Commission's regulations and will provide the appropriate revenue requirement changes.

Finally, the Commission is convinced that a rate reduction or increase will provide the additional flexibility required to respond to the changing telecommunication environment in Kentucky. Though the Commission recognizes that only limited cost studies were available for use in this proceeding, the Commission is not convinced that that is sufficient reason to adopt a status quo approach to rate-making. The Commission is of the opinion that the rate credit mechanism will simply postpone or defer changes in rates and rate structure which have a negative impact on such Commission objectives as universal service.

Therefore, the Commission will adopt rate reductions as the mechanism for sharing of benefits from the incentive regulation plan.

Rate Design

As discussed elsewhere in this Order, the Commission will use rate adjustments to implement any earnings sharing that may occur under the incentive regulation plan. Therefore, the Commission will address proposed rate design.

In prefiled testimony, South Central Bell proposed schedules of rate decreases and rate increases that might occur under the incentive regulation plan. In the case of rate decreases, in

order of priority, South Central Bell proposed to: (1) reduce intraLATA⁵ MTS⁶ and WATS⁷ rates to a level equal to AT&T's interLATA MTS and WATS rates, and reduce interLATA access charges; (2) reduce service charges through adjustments to the trouble determination charge; (3) reduce 1-party zone charges to a level equal to 2-party zone charges; (4) reduce grouping charges through adjustments to the exchange access line rate multiplier; (5) reduce touch tone charges to all classes of service; and (6) reduce exchange access line rates. In the case of rate increases, also in order of priority, South Central Bell proposed to: (1) increase private line service rates, pending a decision in Case No. 10477;⁸ (2) eliminate the directory assistance allowance; (3) implement a late payment charge; and (4) increase exchange access line rates.

The most controversial proposal made by South Central Bell was in the area of MTS and WATS rates. Other items on South Central Bell's schedules received scant attention and, apart from the Attorney General's opposition to any change in rate structure, no specific criticisms were made. Therefore, the Commission will

⁵ Local Access and Transport Area.

⁶ Message Telecommunications Service.

⁷ Wide Area Telecommunications Service.

⁸ Case No. 10477, Proposed Restructuring and Repricing of South Central Bell Telephone Company's Private Line Services Tariff and Access Services Tariff.

accept South Central Bell's rate recommendations, except as modified below.

South Central Bell proposed to reduce intraLATA MTS and WATS rates in the amount of \$20 million,⁹ which it contends is the amount necessary to achieve parity with AT&T's interLATA MTS and WATS rates. Also, South Central Bell contends that a reduction in intraLATA MTS and WATS rates is necessary to respond to competitive alternatives offered by WATS resellers and interLATA carriers.

In prefiled testimony, AT&T echoed South Central Bell's proposed reduction to intraLATA MTS and WATS rates.¹⁰ However, apparently as a result of discovery,¹¹ AT&T modified its position and recommended a lower reduction, in the amount of \$7.8 million.¹² The difference between AT&T and South Central Bell is that AT&T assumes mirrored interLATA and intraLATA MTS and WATS rates in its analysis, at least for the purpose of computing the

⁹ Prefiled testimony of Mr. Anderson, pages 4-5; Responses of South Central Bell to the Commission's Information Request, dated January 20, 1989, Item 2; Tr., pages 106-110 and passim; Brief of South Central Bell, pages 4-8; and Reply Brief of South Central Bell, pages 4-7.

¹⁰ Prefiled testimony of Mr. Sather, Sather Exhibit 3.

¹¹ South Central Bell's Response to AT&T's First Data Request, Item 14.

¹² Tr., pages 32-42 and Brief of AT&T, page 7 and Schedule 3.

revenue change necessary to achieve "revenue parity."¹³ On the other hand, South Central Bell did not fully mirror AT&T's rates in its analysis. Instead, in cases where interLATA MTS rates are lower, South Central Bell reduced intraLATA MTS rates. In cases where interLATA MTS rates are higher, South Central Bell held intraLATA MTS rates constant. Also, in South Central Bell's analysis, WATS rates were estimated based on a 25 percent discount for out-WATS and a 15 percent discount for in-WATS or 800 Service.

The Attorney General opposes rate reductions generally. On the issue of intraLATA MTS and WATS rate reductions, the Attorney General contends that no rate changes should be made until the Commission issues a ruling in Administrative Case No. 323.¹⁴ Also, the Attorney General contends that reductions to intraLATA MTS and WATS rates would violate the sharing provisions of the incentive regulation plan, because South Central Bell's customers would receive only 56 percent of the benefit of such rate reductions.¹⁵ The remaining 44 percent of the benefit would flow to customers of other telephone companies. Furthermore, the Attorney General contends that South Central Bell's proposed reduction to intraLATA MTS and WATS does not result in rate

¹³ Compare with AT&T's Reply Brief, pages 2-3. AT&T contends that the issue is revenue parity as opposed to rate parity. That is, AT&T does not contend that interLATA and intraLATA MTS and WATS rates should be the same.

¹⁴ Administrative Case No. 323, An Inquiry Into IntraLATA Competition, An Appropriate Compensation Scheme for Completion of IntraLATA Calls by Interexchange Carriers, and WATS Jurisdictionality. Prefiled testimony of Dr. Kahn, pages 7-8 and Tr., page 230.

¹⁵ Tr., pages 69-73 and Brief of the Attorney General, pages 7-8.

parity,¹⁶ because South Central Bell does not intend to mirror interLATA MTS and WATS rates.

Contel¹⁷ and GTE¹⁸ oppose South Central Bell's proposed reduction to intraLATA MTS and WATS rates, at least insofar as it might impact other local exchange carriers.

AT&T,¹⁹ the Attorney General,²⁰ and MCI²¹ contend that any rate changes made under the incentive regulation plan should be cost based.

As part of its proposed reduction to intraLATA MTS and WATS rates, South Central Bell also proposed to reduce interLATA access charges, specifically carrier common line charges.²² Initially, interLATA access charges would be reduced at a ratio of 1:9 to intraLATA MTS and WATS rates - i.e., for example, \$1 in access charges to \$9 in MTS and WATS. Subsequently, interLATA access charges would be reduced at a ratio of 1:3.8 to intraLATA MTS and WATS rates - i.e., for example, \$1 in access charges to \$3.80 in

¹⁶ Brief of the Attorney General, page 10.

¹⁷ Prefiled testimony of Mr. Fulp, pages 5-6; Tr., pages 150-151; and Brief of Contel, pages 2-4.

¹⁸ Prefiled testimony of Mr. Farmer, pages 4-6; Tr., page 101; and Brief of GTE, pages 3-8.

¹⁹ Prefiled testimony of Mr. Sather, passim.

²⁰ Prefiled testimony of Dr. Kahn, pages 3-5 and Brief of the Attorney General, pages 3-5.

²¹ Prefiled testimony of Mr. Burnette, pages 4-5.

²² Prefiled testimony of Mr. Anderson, page 5.

MTS and WATS. South Central Bell contends that these ratios are necessary to achieve rate parity.

AT&T is the only party that directly addressed the proposed reduction to interLATA access charges.²³ AT&T agrees that adjustments to interLATA access charges should be a priority. However, AT&T does not link adjustments to interLATA access charges with adjustments to intraLATA MTS and WATS rates. Instead, AT&T recommends discrete adjustments to eliminate WATS rate disparity, reduce South Central Bell's over-recovery of its authorized interLATA revenue requirements, and move toward MTS rate parity. Then, AT&T recommends that interLATA access charges be reduced at a ratio of 1:1.2 to intraLATA MTS and WATS rates - i.e., for example, \$1 in access charges to \$1.20 in MTS and WATS. AT&T contends that this ratio is necessary to achieve revenue parity.

The Commission will retain intraLATA MTS and WATS and interLATA access charges as priorities on its schedule of rate decreases under the incentive regulation plan. However, the Commission will not retain intraLATA MTS and WATS rate adjustments as a high priority and is in agreement with concerns raised by the Attorney General, Contel, and GTE. Neither will the Commission link adjustments to intraLATA MTS and WATS rates with adjustments to interLATA access charges, as these are distinct service offerings operational in different markets. Moreover, the Commission considers MTS and WATS rate parity more important than

²³ Brief of AT&T, pages 7-10 and Exhibit A.

further adjustments to interLATA access charges, which would only serve to exacerbate the existing disparity. However, to obtain rate parity, the Commission will not require South Central Bell to raise rates in the initial intraLATA MTS rate band, as AT&T suggests it should. Such action is not warranted at this time and may be counterproductive. Lastly, the Commission will require that any adjustments to intraLATA MTS and WATS rates be implemented in such a way that the intraLATA toll settlements received by other local exchange carriers are not affected.

As set out in Appendix A, the Commission will adopt the following schedule of rate decreases under the incentive regulation plan: (1) reduce service charges through adjustments to the trouble determination charge; (2) reduce 1-party zone charges to a level equal to 2-party zone charges; (3) reduce grouping charges through adjustments to the exchange access line multiplier; (4) reduce touch tone charges to all classes of service; (5) reduce intraLATA MTS and WATS rates to achieve MTS rate parity and appropriate WATS discounts; (6) reduce interLATA access charges to balance revenues with revenue requirement; (7) reduce intraLATA MTS and WATS rates to reflect any flow-through adjustments to interLATA MTS and WATS that result from adjustments to interLATA access charges during the course of the incentive regulation plan; and (8) reduce exchange access line rates on a residual basis.

Some comments concerning the administration of Appendix A are in order. First, the Commission views each priority as an objective to be achieved before the next priority is engaged.

Thus, for example, the total reduction of \$4.5 million in service charges should be achieved over one or more points of test before the next priority is engaged, and so on. Second, the Commission intends to be flexible and exercise reasonable discretion in the administration of Appendix A. Events beyond the scope of the instant consideration or information filed at points of test may require technical or substantial modifications to Appendix A. For example, changes in demand quantities that occur over time may require technical modifications to achieve overall objectives. Also, for example, the impact of open network architecture rules or the impact of unforeseen regulatory actions may require substantial modifications to the indicated list of priorities. Third, the Commission expects South Central Bell to file demand price-out information along with other relevant information at each point of test where rate adjustments are indicated.

As to specific priority items in Appendix A, South Central Bell proposed a maximum adjustment of \$4 million to service charges. The Commission has added a slight increment to this amount. The objective is a reduction of \$4.5 million to service charges, or the total amount necessary to reduce the trouble determination charge from \$0.90 to \$0.25 per month. Based on cost information filed in this case, at this rate level the trouble determination charge is still priced substantially above directly attributable cost.²⁴

²⁴ Response of South Central Bell to the Commission's Information Request, dated January 20, 1989, Item 11.

A trouble determination charge applies for a service dispatch in connection with a customer's service difficulty or trouble report when it is determined that the source of the difficulty or trouble is within the customer's home or place of business. As options, customers can elect to pay a monthly recurring rate, discussed above, or more costly non-recurring charges for each service dispatch involving trouble determination. The latter charges are a particular source of customer complaint and concern. The action taken in this Order should result in an eminently affordable alternative to non-recurring charges and should stimulate demand for the recurring monthly option.

South Central Bell proposed a maximum adjustment of \$7 million to zone charges. However, demand price-out information filed in the case shows available revenues to be approximately \$6.7 million.²⁵ In any event, the objective is to reduce 1-party zone charges to 2-party levels.

Zone charges apply to customers located outside the base rate area and are in addition to local exchange access line rates. As such, zone charges are another source of customer complaint and concern. Reducing 1-party zone charges to 2-party levels will afford some rate relief. The Commission does not take this action lightly. Information filed in past rate cases indicates that zone charges do not recover the total cost of service outside the base

²⁵ Demand Price-out of South Central Bell, Tariff Sections A3.9.2 and A3.9.3.

rate area, at least in the short run. However, development of fiber optic and other new technologies should diminish and may eliminate any past discrepancy between zone charges and cost of service.²⁶ Also, South Central Bell indicates that 55 percent of 2-party customers are on a line alone, effectively giving them 1-party service at 2-party rates.²⁷ Such a situation is not reasonable.

South Central Bell proposed a maximum adjustment of \$8 million to grouping service. The Commission will authorize a maximum adjustment of \$7.4 million, or the amount necessary to reduce grouping charges from 55 percent to 30 percent of applicable exchange access line rates.

Grouping service involves a combination of 2 or more access lines connected to a central office such that incoming calls overflow to the next available access line if the initially dialed access line is busy. Charges for grouping service are based on a percentage of applicable exchange access line rates. South Central Bell proposed to, first, reduce the grouping service multiplier from 55 percent to 50 percent of applicable exchange access line rates and, then, establish 50 percent of applicable rate group 1 exchange access line rates as the maximum grouping charges. The Commission cannot accept the latter portion of South Central Bell's proposal, as it involves value-of-service issues

²⁶ Prefiled testimony of Mr. Anderson, pages 6-7 and Brief of South Central Bell, page 8.

²⁷ Ibid.

that would be more appropriately considered in a general rate case investigation. Instead, as indicated, the Commission will expand the former portion of South Central Bell's proposal to accomplish a reduction to grouping charges consistent with South Central Bell's recommended maximum adjustment. In the judgment of the Commission, such action is not inconsistent with cost-of-service principles, as grouping service is priced to provide substantial contribution.²⁸

South Central Bell proposed a maximum adjustment of \$12 million to touch tone charges. The Commission will authorize a maximum adjustment of \$11.9, or the amount necessary to eliminate touch tone charges, which is implicit in South Central Bell's recommendation.

On the matter of touch tone charges, it is not clear to the Commission that South Central Bell intended to eliminate touch tone charges.²⁹ General exchange touch tone charges are a source of substantial contribution. Also, in addition to general exchange service, touch tone and touch tone-like charges are important basic service elements in the open network architecture environment. Therefore, the Commission will entertain a motion from South Central Bell to modify this priority.

²⁸ South Central Bell's Response to the Commission's Request for Information, dated January 20, 1989, Item 14; Tr., page 119; and Brief of South Central Bell, pages 8-9.

²⁹ South Central Bell refers to moving touch tone rates closer to cost, not to the elimination of touch tone rates. See, for example, Brief of South Central Bell, page 9.

Items pertaining to interLATA MTS and WATS and interLATA access charges have been discussed elsewhere in this Order.

Lastly, the Commission will allow residual adjustments to exchange access line rates. Any such adjustments should be pro rated across rate groups and classes of service, subject to restoration of the rate relationships authorized in Case No. 9160.³⁰ The Commission will not authorize the unbundling of local usage and exchange access, as proposed by South Central Bell. In the opinion of the Commission, such an action would be premature in view of a pending decision in Administrative Case No. 285.³¹

Also, as indicated elsewhere in this Order, South Central Bell's proposed schedule of rate increases under the incentive regulation plan received limited attention in this investigation. Therefore, the Commission will accept South Central Bell's schedule of rate increases, except as modified in Appendix B. Specifically, the Commission will eliminate private line services as a priority, as private line services are under consideration in Case No. 10477. Also, due to public policy reservations concerning the elimination of directory assistance call

³⁰ Case No. 9160, Petition of South Central Bell Telephone Company to Change and Increase Certain Rates and Charges for Intrastate Telephone Service.

³¹ Administrative Case No. 285, An Investigation Into the Economic Feasibility of Providing Local Measured Service Telephone Rates in Kentucky.

allowances, the Commission will lower its priority ranking as indicated in Appendix B.

ORDERS

The Commission, having considered the evidence of record and being sufficiently advised, HEREBY ORDERS that:

1. Rate changes rather than credits or refunds shall be used to implement any earnings sharing under the incentive regulation plan.

2. The schedule of rate decreases in Appendix A, attached and incorporated hereto, is adopted.

3. The schedule of rate increases in Appendix B, attached and incorporated hereto, is adopted.

4. South Central Bell shall file according to the above Appendices at each point of test.

Done at Frankfort, Kentucky, this 27th day of April, 1989.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 10105 DATED 4/27/89

Kentucky Incentive Regulation Plan Schedule of Rate Decreases

<u>Priority</u>	<u>Service</u>	<u>Maximum Adjustment (Millions)</u>	<u>Notes</u>
1.	Service Charge	\$4.5	Reduce trouble determination charge to \$0.25 per month.
2.	Zone Charges	6.7	Reduce 1-party zone charges to 2-party levels.
3.	Grouping	7.4	Reduce grouping charges from 55 percent to 30 percent of applicable.
4.	Touch Tone	11.9	Eliminate touch tone rates.
5.	MTS/WATS	20.1	Reduce MTS \$14.6 million. Reduce WATS \$5.5 million. Price MTS for rate parity. Price out-WATS for a 25 percent discount. Price in-WATS or 800 Service for a 15 percent discount.
6.	Access Charges	6.1	Reduce access charges to \$37.2 million in total revenue.
7.	MTS/WATS/ Access Charges	-	Reduce MTS/WATS to reflect future flow-through adjustments to access charges, including the flow-through impact of priority no. 6.
8.	Exchange Access Line	Residual	Price exchange access line rates to restore appropriate rate ratios authorized in Case No. 9160.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 10105 DATED 4/27/89

Kentucky Incentive Regulation Plan
Schedule of Rate Increases

<u>Priority</u>	<u>Service</u>	<u>Maximum Adjustment (Millions)</u>	<u>Notes</u>
1.	Late Payment Charge	\$1.8	Implement charge for late payments.
2.	Miscellaneous Services	1.0	Increase rates for services in GSST sections A.13, A.113, A.14, and A.114 across-the-board. Eliminate call allowances.
3.	Directory Assistance	1.8	Eliminate call allowances.
4.	Exchange Access Line	Residual	